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Summary of the Economic and Social Survey of Asia and the Pacific 2013

Summary

Development in Asia and the Pacific is under pressure, with the region being increasingly buffeted by the travails of the developed world. Economic growth in the developed world continued to slow in 2012 as the eurozone fell into a so-called double-dip growth contraction and growth in the United States of America remained anaemic. As a result of the slowdown in demand in the developed world, there was a broad-based deceleration in the Asia-Pacific region in 2012. The generalized downtrend across the region involved such structural issues as rising inequality and shortages in energy and infrastructure owing to past policy mistakes and inappropriate policy responses. The solution to invigorating the domestic drivers of growth in the region lies in making the development process more inclusive and sustainable.

In the *Economic and Social Survey of Asia and the Pacific 2013*, it is argued that the developmental role of macroeconomic policies has been seriously neglected in the region and that this situation has critical implications for poverty, inequality and economic security. The *Survey* therefore argues for a shift in the development paradigm that would require forward-looking macroeconomic policies in order to bring back the balance between stabilization and developmental roles. In the *Survey*, it is advocated that greater emphasis be placed on the quality and composition of public expenditure, rather than aggregate budget deficits or public debts. The *Survey* contains illustrative examples of a set of policies to enhance the region's resilience and inclusiveness; these examples show that the cost of such policies is affordable and fiscally sustainable and would not destabilize the macroeconomy. Such policies include the provision of an employment guarantee for a limited number of days per year, basic social services (education and health care), income security for older persons and persons with disabilities and measures to ensure efficient energy for all by 2030.

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The Economic and Social Commission for Asia and the Pacific may wish to deliberate on these issues and propose policy recommendations for promoting inclusive and sustainable development in the region.

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I. Introduction

1. The Rio Declaration on Environment and Development,[1] emphasizes that environmental protection and social development must be integral parts of the development process. Each of these areas has a distinct focus in addition to economic development; yet, all three are mutually reinforcing and interdependent. The need to mainstream all of them into the development policies and programmes of all countries was reaffirmed at the United Nations Conference on Sustainable Development (Rio+20), held in Rio de Janeiro, Brazil, in June 2012.

2. The global leaders gathered at the Rio+20 Conference also called for the adoption of forward-looking macroeconomic policies that promote sustainable development and lead to sustained, inclusive and equitable economic growth. In recognizing the lessons learned and successful policies and approaches in the implementation and achievement of the Millennium Development Goals, Government leaders made the same call in September 2010 in the outcome document of the High-level Plenary Meeting of the sixty-fifty session of the General Assembly.[2]

3. For the Asia-Pacific region, the term "inclusiveness" needs to be explicit since the miracle of rapid economic growth has been uneven. Despite significant reductions in poverty, the region is still home to more than 800 million poor people, accounting for nearly two thirds of the world's poor, who struggle to survive on an income of less than $1.25 a day. An almost equal number of people in the region are "near poor" or remain vulnerable to poverty, using the $2-per-day poverty line. Moreover, income inequality has risen and economic security has deteriorated amid rapid economic growth. More than 1 billion workers in the region are in vulnerable employment and more than 500 million people remain undernourished.

4. The situation is not helped when most Asia-Pacific developing countries do not have a comprehensive social protection system to assist people in regenerating their livelihoods when they have been affected by economic crises, natural disasters or personal misfortunes. Thus, despite showing remarkable resilience to economic crises, the people living in this region are becoming increasingly vulnerable to them.

5. Enhancing resilience and the inclusiveness of the development process must therefore be explicitly recognized as key priorities for the Asia-Pacific region. Because of their interconnectedness, development strategies aimed at enhancing resilience and inclusiveness mutually reinforce each other and thereby strengthen all three pillars of sustainable development.

6. The *Economic and Social Survey of Asia and the Pacific 2013* examines how the ongoing global economic crisis is affecting the inclusiveness and sustainability of the region's development process and the extent to which its impacts are exacerbated by structural impediments caused by past policy inadequacies. The *Survey* argues for a shift in the development paradigm that would require forward-looking macroeconomics in order to restore the balance between stabilization and developmental roles of macroeconomic policies. There has to be greater emphasis on the quality and composition of public expenditure rather than aggregate budget

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[1] See *Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992*, vol. I, *Resolutions Adopted by the Conference* (United Nations publication, Sales No. E.93.I.8 and corrigendum), resolution 1, annex I.

[2] General Assembly resolution 65/1.

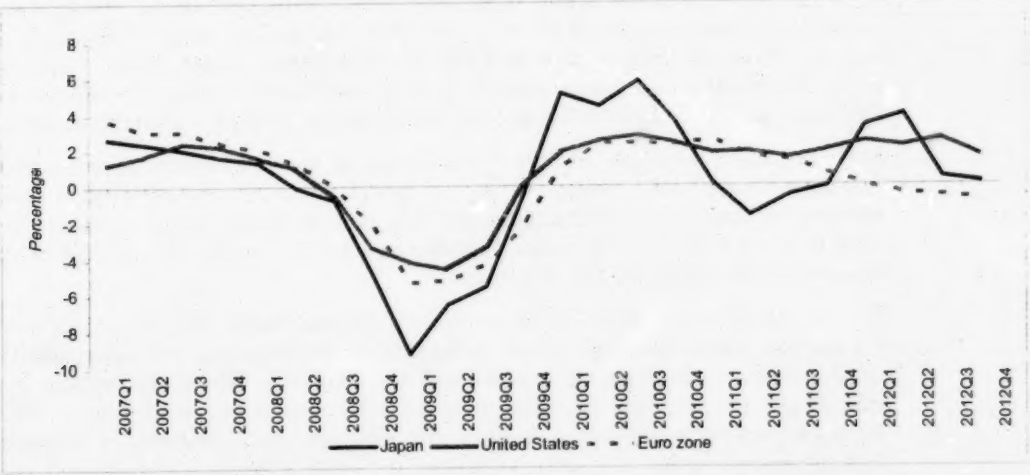
deficits or public debts. The *Survey* also provides some illustrative examples of a set of policies to enhance the region's resilience and inclusiveness, with estimates of their fiscal cost.

7. These forward-looking policies include the provision of an employment guarantee for a limited number of days per year, basic social services (education and health care), income security for older persons and persons with disabilities and measures to ensure that there will be efficient energy for all by 2030. The required investment for this policy package is affordable and fiscally sustainable and will not destabilize the macroeconomy. Importantly, "social protection must not simply be seen as a handout. It is an investment in inclusive growth. It is an investment in human capabilities to get people out of exclusion and poverty and to build resilience to risks and vulnerabilities".[3]

II. Growth outlook to remain subdued

8. Development in Asia and the Pacific is under pressure, with the region being increasingly buffeted by the travails of the developed world. Economic growth in the developed world continued to slow as the eurozone fell into a so-called double-dip growth contraction, and growth in the United States of America remained anaemic (see figure 1 below). As a result of the slowdown in demand in the developed world, the Asia-Pacific region experienced a broad-based slowdown in 2012.

Figure 1
Real GDP growth in major developed economies, quarter by quarter, year on year, 2007-2012

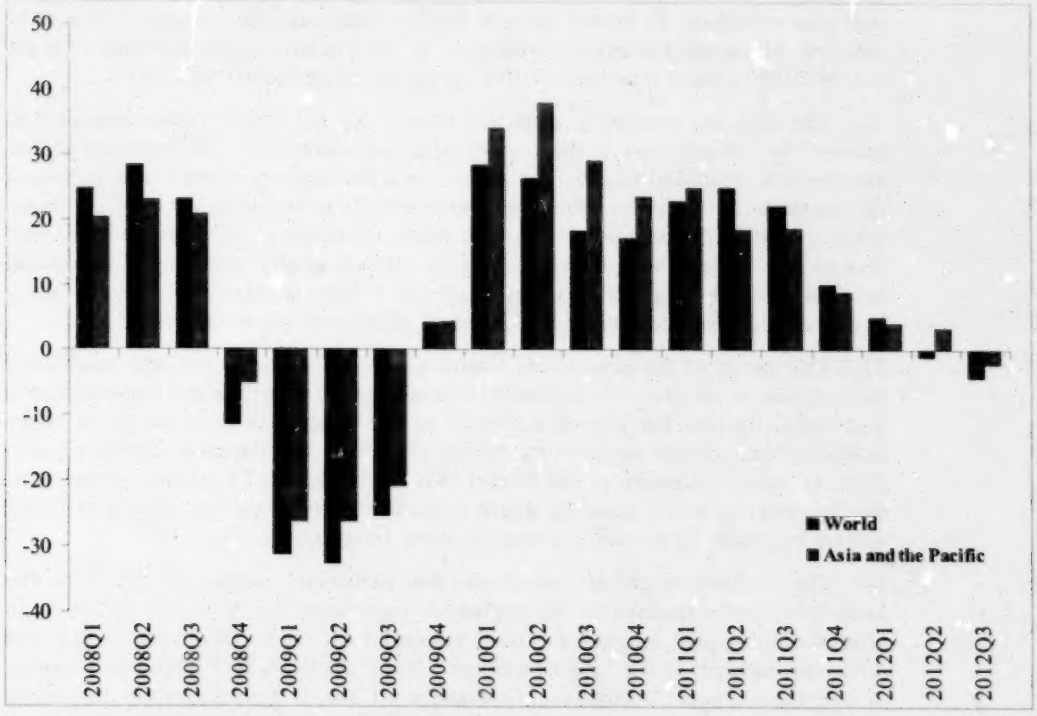


Source: Economic and Social Commission for Asia and the Pacific (ESCAP), based on data from CEIC Data Company Limited, available from http://ceicdata.com.

[3] Noeleen Heyzer, Keynote speech at the Regional Conference on Enhancing Social Protection in Asia and the Pacific, held at the Asian Development Bank Headquarters in Manila, on 21 and 22 April 2010.

9. A number of large economies in Asia and the Pacific, most notably China and India, which proved resilient in the early part of the crisis, also slowed markedly in 2012; this situation reduced the level of support to other Asia-Pacific economies previously provided through the channel of intraregional demand. As a result of the generalized slowdown, the Asia-Pacific region started to experience a contraction in trade after mid-2012 (see figure 2 below).

Figure 2
Recent developments in export growth in the Asia-Pacific region
(Year-on-year percentage change)



Source: ESCAP calculation, based on World Trade Organization online short-term merchandise statistics (accessed in February 2013).

10. There was some diversity in economic performance across subregions. The South-East Asian subregion as a whole achieved higher economic growth in 2012 than in 2011, despite weakening external demand. Private consumption was strong and supported by policy measures, such as minimum wage increases, while investment benefited from increased public infrastructure outlays. All the economies in the East and North-East Asian subregion, except Japan, registered lower growth rates in 2012. However, the gross domestic product (GDP) growth rate in China was still among the highest in the world. Although economic performance in the North and Central Asian subregion remained robust at the beginning of 2012, most economies began to feel the impact of the deteriorating external economic environment in the latter part of the year. The Pacific island developing economies generally slowed in 2012. Papua New Guinea, a resource-rich economy that is the

largest in the subregion, continued to achieve high growth but at a slightly lower rate compared with 2011. Although growth performance in many of the countries in the South and South-West Asian subregion is less dependent on foreign demand, the global slowdown has still had an adverse impact on exports and consequently on economic growth. Moreover, domestic demand, particularly investment, has also been characterized by slower growth.

11. The near-term economic performance of the region is likely to pick up in 2013 but will still be below its growth potential. Developing Asia-Pacific economies as a group are projected to expand by 6.2 per cent in 2013, up slightly from 5.7 per cent in 2012.[4] Within the region, the effects of earlier policy easing and fiscal stimulus will also contribute to higher growth, but any improvement in prospects will be subdued. Moreover, the expected rebound in 2013 is still below the trend of 8 per cent in 2010/11 and 8.5 per cent during the pre-crisis period of 2002-2007.

12. The inflation forecast is generally modest for 2013, with prices projected to increase by 5.0 per cent in the region. Although inflation is not expected to rise sharply, it is important to note that prices are high, causing severe hardship among the poorest and most vulnerable sectors of society in many economies. Furthermore, while overall inflation may not rise in many economies, the key food and fuel sectors may face price pressure owing to global supply concerns. The overall moderate outlook for inflation is due to growth remaining relatively weak, resulting in reduced domestic demand-pull factors and inflationary expectations.

13. The impact of the generalized slowdown in 2012 on inclusive and sustainable development in the region is expected to be substantial, with job and income growth expected to decline. Job growth is already on the wane, with 10 of the 13 countries in the region recently sampled exhibiting a year-on-year decrease compared with 2011. Of critical concern is the impact that the slowdown in income growth will have on poverty and inequality. There is great anxiety about the impact of rising income inequality on the achievement of social indicators.

14. The challenging global outlook has had particularly important effects on the least developed countries in the region. A significant worry is the reduction in official development assistance (ODA) commitments of the developed world as a direct consequence of the "great recession". Net ODA flows from member countries of the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD) amounted to $133.5 billion in 2011, a decline in real terms of 3 per cent, thus widening the delivery gap in meeting the internationally agreed aid targets of 0.7 per cent of gross national income, which would amount to $167 billion.[5] Under these constrained circumstances, least developed countries have still received considerable support as a result of the ongoing remittances contributed by their overseas workers. Asia-Pacific economies received a record $219 billion in remittances in 2012, with Bangladesh and Nepal being among the top 12 recipients in the region in terms of value and proportion of GDP.[6] While the growing comparative role of remittances as a source of capital is

[4] Data and projections as at 5 March 2013.

[5] *World Economic Situation and Prospects 2013* (United Nations publication, Sales No. E.13.II.C.2), p. viii. Available from www.un.org/en/development/desa/policy/wesp/wesp_current/wesp2013.pdf.

[6] Dilip Ratha and Ani Silwal, "Migration and Development Brief 18", (Washington D.C., World Bank), 2012. Available from http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1110315015165/MigrationandDevelopmentBrief18.pdf.

welcome, their primary significance remains confined at the household level, namely, providing livelihood support and opportunities to escape poverty. Furthermore, since many of these remittances have been generated from within the region, this trend may not last if the generalized slowdown in the region deepens. Therefore, it is important to bear in mind that ODA continues to remain important for developing economies owing to the critical role that it plays in budget support for the provision of such public goods as roads, water supply, education and health care.

15. The slowdown in the two developing powerhouses in the region, China and India, has been the key new fear for the smaller economies in the Asia-Pacific region, adding to existing difficulties in recent years stemming from the crisis in the developed world. The slower growth in the region's major economies will have immediate demand impacts for the smaller exporting economies. However, a more positive development in the medium term is likely to occur as a result of the increased rebalancing in China as it attempts to become a more consumption-led economy in line with the Government's efforts to address the problem of growing inequality and regional imbalances by bolstering the income of the poor, particularly in rural areas, through the stimulation of economic activity in rural and less developed regions. Such a policy approach can produce a net positive impact on other countries in the region by creating new sources of demand in China's economy.

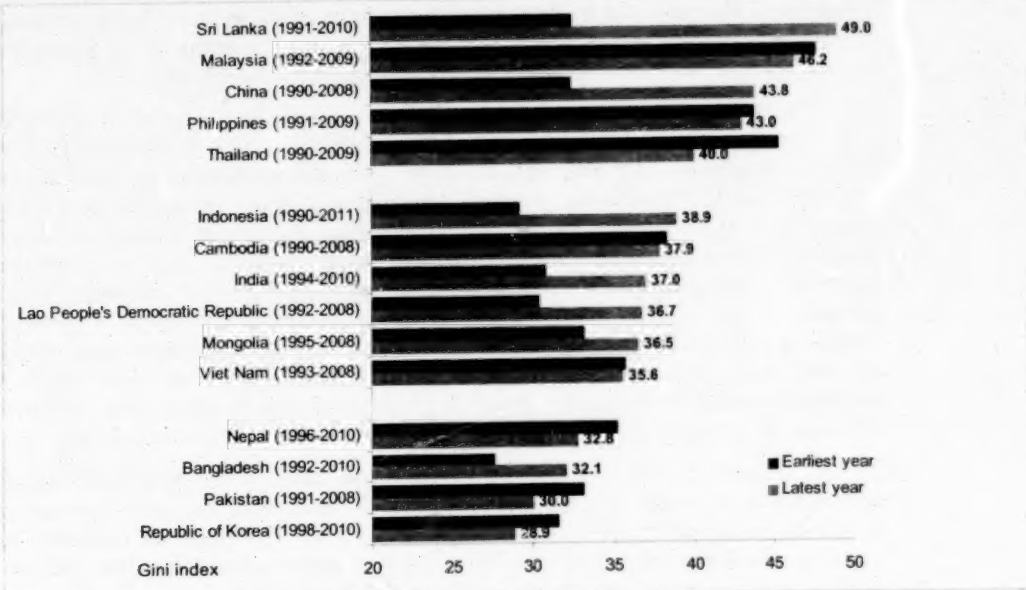
16. Confronted by the challenges of slowing demand in the developed world, economies in the region will have to look towards undertaking supportive measures at the domestic and regional levels to maintain their development progress. In addition, Governments will have to take action to ensure specifically that the jobs and incomes of the poorest and most vulnerable sections of society are protected during this difficult period. One of the policies that is gaining increased resonance in the region is the introduction of minimum wage requirements to ensure the livelihoods of citizens.

III. Structural impediments to continued progress

17. The generalized deceleration across the region in 2012 points to structural issues, such as rising inequality, and energy and infrastructure shortages, owing to past policy mistakes and inappropriate policy responses. The underlying causes of the difficulties currently being faced go beyond the impacts emanating from the developed world. The slowdown even among the economies in the region with large domestic markets clearly demonstrates the shortcomings of the development strategies that have been pursued over the past few decades.

18. Key evidence of structural deficiencies are demonstrated, for instance, by the fact that declines in poverty in the region have been accompanied by greater levels of inequality (see figure 3 below). Inequality in the region has been exacerbated by the failure of fiscal policy to play its distributional role through making the tax structure broad-based and more progressive and providing for increased expenditure in the public provisioning of essential services, including social protection. In fact, Asia-Pacific economies as a group have the lowest tax burden of any developing region in the world. There is a clear negative relationship between the tax burden of countries in the region and their levels of inequality. The negative relationship is more pronounced between public social expenditure and levels of inequality.

Figure 3
Income inequality in selected Asia-Pacific developing economies, 1990s, and latest available data



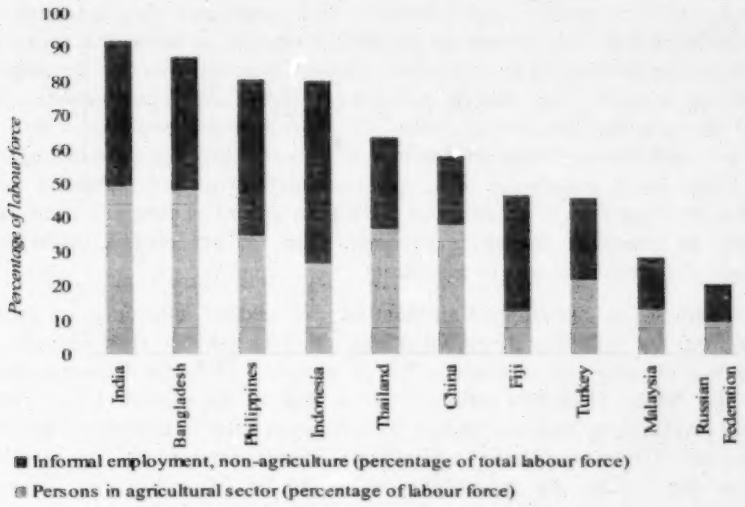
Source: World Bank, PovcalNet data, supplemented by household survey data from India and the publications of the National Statistical Office of the Republic of Korea.

19. In spite of significant progress in recent years in a number of countries, including through extending the provision of basic health-care access and income support to poor workers and households, Asia-Pacific countries still exhibit significant shortcomings in their social protection regimes. Public social security expenditure remains low at less than 2 per cent of GDP in half the countries where data are available. In addition, only 30 per cent of persons older than 65 years of age in Asia and the Pacific on average receive a pension, and only 10 per cent of the unemployed receive any benefits.[7] Vulnerable employment is a persistent issue within the Asia-Pacific region (see figure 4 below). Despite high rates of economic growth within East Asia, more than half the region's workforce has a vulnerable employment status. This figure is considerably higher in South Asia.[8]

[7] International Labour Organization, *World Social Security Report 2010/11: Providing Coverage in Times of Crisis and Beyond* (Geneva, 2010); and Florence Bonnet, Catherine Saget and Axel Weber, "Social protection and minimum wages responses to the 2008 financial and economic crisis: findings from the ILO/World Bank Inventory", Employment Working Paper No. 113 (Geneva, International Labour Organization, 2012).

[8] International Labour Organization, *Asia-Pacific Labour Market Update* (April 2011). Accessed on 19 November 2012. Available from www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/publication/wcms_154215.pdf.

Figure 4
Informal unemployment as a percentage of the total labour force



Source: ESCAP, based on the World Bank's World Development Indicators database.

20. Vulnerability of employment and inequality are both inimical to domestic demand. As indicated previously, inequality and vulnerability have been exacerbated by the failure of Governments to raise tax revenues through a broad-based and progressive tax structure. This has constrained their ability to spend on basic social services, including social protection. Progressive taxation and social protection measures not only reduce inequality, but also lessen vulnerability by acting as automatic stabilizers. Low tax revenue restricts Governments' fiscal space and hence their ability to boost domestic demand when needed. Therefore, reform of the tax structure, including improving the efficiency of tax administration and widening the tax base, is of utmost urgency for most Asia-Pacific countries, especially when they have to find domestic drivers of growth in the face of diminished prospects for exports.

21. The Asia-Pacific region suffers from large infrastructure deficits, although there are significant variations among countries. Infrastructure deficit is clearly an impediment to growth, especially in South Asia. Investment climate assessment surveys of firms in South Asia show that infrastructure is a "major" or "severe" obstacle to business expansion. Power is the most critical bottleneck, with transportation being a close second. Traffic congestion has become a common feature in most Asian cities, but its costs can be as high as 2 per cent of GDP.

22. Agriculture accounts for a quarter of GDP in the region's developing countries; this sector employs about 60 per cent of the region's working population and accounts for the majority of the poor. Yet, the agricultural sector has suffered from decades of neglect, as pointed out in the *Economic and Social Survey of Asia*

and the Pacific 2008.[9] This has weakened the sector's capacity to cut poverty and inequality. Structural impediments to productivity growth in agriculture include inequality in land ownership, lack of human capital development owing to limited access to health-care services and education, and inadequate rural infrastructure. These impediments are largely owing to macroeconomic policies that resulted in declines in public investment in agriculture, especially in research and development and extension services, and cuts in agricultural credit and input subsidies. The neglect of the rural and agricultural sector is evident from the inequalities that exist in access to health-care services, education and infrastructure. For example, nearly a quarter of the rural population does not have access to safe drinking water, compared with 7 per cent in urban areas. Less than a third of people in rural areas have access to improved sanitation, compared with 70 per cent in urban areas. Similar gaps also exist in access to education.

23. Improvement in agricultural productivity is needed not only to provide insulation from the volatility of global markets and to enhance food security, but also to reduce poverty and inequality. The Economic and Social Commission for Asia and the Pacific (ESCAP) estimates show that an increase of 1 per cent in agricultural productivity would lead to a 0.37 per cent drop in poverty in the Asia-Pacific region. Given the large agricultural labour productivity gaps among countries in the region, the potential gains would be substantial. For example, raising the region's average agricultural productivity to that of Thailand could lift 218 million people out of poverty.

24. Industrialization and an expanding and increasingly affluent consumer base have boosted the demand for all kinds of resources. Trends in the use of biomass, energy, construction and other minerals show that, while the economies of other regions of the world are becoming less resource-intensive over time, the Asia-Pacific region is requiring more resources to produce a dollar of GDP as the economy grows. While growing affluence is mainly to blame for environmental pressures related to resource use, persistent inequality with regard to access to basic services is also implicated. Some 800 million people are without access to modern forms of energy, mainly in rural areas. This situation constrains overall socioeconomic progress, and lack of access to electricity also drives a vicious cycle in which the need for wood and other biomass-based forms of energy promotes extraction from the natural environment.

25. The perception that intensive resource use and environmental degradation are acceptable phenomena in a "grow now, clean up later" approach to development is imposing significant socioeconomic costs — costs most often borne by the most vulnerable in society. Extreme weather events, which may be related to climate change, add to these costs. Economic losses are just one facet of the implications of resource-intensive growth patterns for development. In a joint ESCAP, Asian Development Bank and United Nations Environment Programme (UNEP) publication,[10] it is pointed out that, while there is a need to continue to elevate standards of living, this must be achieved based on resource-efficient, rather than

[9] United Nations publication, sales No. E.08.II.F.7.

[10] See ESCAP, Asian Development Bank and United Nations Environment Programme, *Green Growth, Resources and Resilience: Environmental Sustainability in Asia and the Pacific* (ST/ESCAP/2600) (Bangkok, 2012). Available from www.unescap.org/esd/environment/flagpubs/ggrap/documents/Full-Report.pdf.

resource-intensive, growth strategies. In a context of high and volatile resource prices and increasingly evident resource constraints, a resource-intensive growth pattern translates into an economy with higher exposure to risk, especially for the most vulnerable in society. Resource efficiency is increasingly an economic risk management strategy on both economic and social fronts.

26. The region faces other types of risk as well. Asia and the Pacific is the world's most disaster-prone region. In 2012, floods and storms were the most frequent type of disaster in the region and had the greatest human and economic impact. Vulnerability to disasters continues to increase while economic development is exposing ever-growing numbers of people and assets to disasters. Never before has the need for collaborative action to reduce risk, vulnerability and exposure of populations and assets been more obvious and necessary for the common good. The shared challenge in Asia and the Pacific is to control both the growing rate of exposure and rising vulnerability. Well-targeted investment in disaster risk reduction and management can reduce vulnerability and exposure to disasters. Social protection, designed in a more resilient manner by taking into account poverty alleviation and focusing on the underlying causes, can reduce people's vulnerability during and after a disaster event. Scaling up vulnerability reduction measures in high-risk areas, land-use planning, supply chain management and targeted social safety nets for the most vulnerable within a universal social protection system have the potential to significantly reduce disaster risks. Furthermore, regional cooperation can be used for cost-effective sharing of highly sophisticated and sometimes costly information and communications technology and space technologies.

27. In addition to structural impediments faced by the region in general, some constraints and challenges are more specific to various subregions. Income inequalities and population ageing are major concerns in East and North-East Asia. Policymakers are conscious of the need to adapt the broad normative and institutional environment in a way that is conducive to more inclusive and sustainable development. In the South-East Asian subregion, productive jobs, social protection and clean energy are among the key challenges for achieving inclusive and sustainable development. North and Central Asia continue to face serious challenges owing to their reliance on commodity exports, including oil and gas, making them highly exposed to the external economic environment. Further diversification of these economies will always remain a challenge. Since most of these countries are landlocked, trade and transit issues are highly relevant to them. The Pacific island developing economies face unique challenges, including small populations, a poor resource base (except in a few exceptional cases), remoteness from their more developed trading partners, frequent natural disasters and adverse impacts from global climate change. These constraints make it difficult for them to achieve high economic growth rates on a sustained basis. South and South-West Asia, which is home to the highest number of poor and malnourished people compared with all other subregions in Asia and the Pacific combined, needs to maximize its growth potential and increase productive employment opportunities by reviving industries in order to further reduce poverty and hunger.

A. The solution: inclusive and sustainable development

28. The solution to invigorating the domestic drivers of growth in the region lies in making the development process more inclusive and sustainable. In the social sphere,

making development more inclusive will spur consumption by the majority of the population in many developing economies, namely, the poorest and most vulnerable members of society. Improvement in taxation bases, tax administration and tax progressivity will also be important for generating necessary revenues to fund both ongoing economic development and a supporting regulatory environment for improved social and environmental performance. The resultant shift towards a more inclusive development paradigm would ultimately set the course to ensure sustainable development in the Asia-Pacific region. In the environmental sphere, the current failure of countries to tackle degradation in their natural environment is impeding the ability of their economies to perform at their full potential. Issues that have a direct bearing on the quality of economic growth include deforestation, damage to water and energy sources, and air pollution. The approach to addressing the social and structural deficits lies in Government action.

B. Regional cooperation in times of uncertainty

29. There is always a danger of competition among countries when they are all facing shrinking export markets and experiencing declines in foreign investment. Countries must avoid a race to the bottom by competing among themselves to lure foreign investment, often with tax concessions or by applying easier terms with regard to protection of the environment and labour rights. Such beggar-thy-neighbour policies do not help any country in the end, and they are harmful to inclusive and sustainable development. Instead, countries should enhance regional cooperation, in particular in addressing their large infrastructure deficits and other impediments that are cross-border in nature. Rather than undermining an individual country's efforts, countries should act together to raise the living standards of their people, for example by increasing the minimum wage, which would expand regional markets for all of them.

Forward-looking macroeconomics for resilient, inclusive and sustainable development

30. Macroeconomic policies that evolved in industrialized countries in the era following the Second World War were aimed primarily at achieving internal balance, defined as full employment and price stability, and external balance, defined in terms of "equilibrium" in the current account component of the balance of payments. However, the breakdown of the Bretton Woods system of fixed exchange rates and the oil price shocks in the 1970s led to a de facto abandonment of the principle of balancing growth, full employment and price stability. Henceforth, internal balance was confined to price stability in the belief that such balance and everything else, including economic growth, would follow. Consequently, fiscal policy was stripped of its developmental and redistributive roles as low budget deficits were now regarded as essential for keeping inflation low and the balance of payments sustainable.

31. The excessive focus on stabilization led to neglect of the developmental role of macroeconomic policies. This has had serious implications for poverty, inequality and economic security. Moreover, advice to Governments to reform their tax structure by reducing direct (income and corporate) taxes and increasing indirect taxes reduced tax progressivity and its ability to serve as a redistributive tool. Cuts in public provisioning of basic social and economic services and the introduction of

the user-fee principle contributed to increasing inequality, even where there was rapid economic growth. The diminished fiscal space has limited the ability of Governments to pursue countercyclical fiscal policies; worst of all, the focus on aggregate debts and deficits or inflation made macroeconomic policies procyclical.

C. Bringing back the balance: stabilization is necessary but not sufficient

1. Fiscal policy: the composition of Government expenditure matters

32. As emphasized in the *Economic and Social Survey of Asia and the Pacific 2009*,[11] the composition of Government expenditure clearly matters. For instance, public investment in developing countries is crucial, especially in areas characterized by lumpy investments, long gestation lags and relatively lower profits, all of which make the private sector unwilling to enter such areas. Critical areas include infrastructure, health care, education and social security, all of which have important positive growth effects. The front-loading of massive public investments is important, particularly in the areas of renewable energy and smallholder food agriculture, to induce complementary private investments. This is even more the case in the context of the ongoing global economic recession and high volatility of food prices. Public procurement can be used to direct production and consumption towards greener and more labour-intensive activities.

33. Governments can also use public procurement to direct production and consumption towards greener and more labour-intensive activities. Government procurement expenditures are a significant source of aggregate demand in Asian and Pacific countries. In a sample of 19 countries, including Australia, China, India, Japan, New Zealand and the Russian Federation, the total of such expenditures amounted to $582 billion in 2010.

34. In 2010, Governments in Asia and the Pacific allocated 18.6 per cent of their total expenses to procurement, an amount that is between the corresponding figures for countries in the European Union (13.8 per cent) and for North America (22.1 per cent). Moreover, several countries spent a larger share of their general Government expenses on procurement that year, ranging from 28.2 per cent in New Zealand to 43 per cent in Kazakhstan. With such large expenditures on procurement, Asia-Pacific countries could leverage the private sector towards greener and more labour-intensive activities. This type of action can be an important fiscal policy instrument for inclusive and sustainable development.

35. There should thus be more scrutiny of the composition of fiscal expenditure instead of overall deficits or debts. This is particularly the case since, in the past, countries suffering from high and unsustainable debt generally have either spent on unproductive sectors or have failed to collect enough revenue when the economy was growing.

2. Monetary policy: targeting very low inflation can hurt growth

36. Policymakers are usually advised to target inflation at a low single-digit level. Yet, a large number of studies show that the relationship between inflation and

[11] United Nations publication, sales No. E.09.II.F.11.

growth is non-linear — positive up to a moderate level and negative thereafter. The threshold beyond which inflation adversely affects growth varies. It is higher for countries at an early stage of development. For example, several Asia-Pacific developing countries grew amid relatively high inflation, including Indonesia, Kyrgyzstan, the Lao People's Democratic Republic, Mongolia, the Republic of Korea, Sri Lanka, Tajikistan and Uzbekistan. In these countries, growth performance exceeded 5 per cent amid high inflation.

37. Contrary to common belief, moderate inflation may not harm efforts to reduce poverty. Poverty rates dropped dramatically in both Indonesia and the Republic of Korea between the mid-1960s and the mid-1980s despite an inflation rate ranging from 13 per cent to 17 per cent. Although inflation results in lower real wages, it also encourages firms to expand employment. Several studies have found that the employment effect of moderate inflation is larger than its real wage effect, resulting in a net positive effect on poverty reduction. Inflation also reduces the real value of debt and is therefore likely to benefit the poor, who are usually net debtors. Monetary policy that controls price inflation, especially inflation that is caused by supply shocks, may harm the poor if it causes job loss, particularly since unskilled workers usually lose jobs first. Therefore, as a rule, monetary authorities should not react to inflation without first analysing its causes and disaggregated impacts.

38. The targeting of inflation at too low a level can constrain growth, especially when it is achieved by keeping interest rates high, since access to finance is critical, particularly for small and medium-sized enterprises and agriculture. While monetary tightening to tackle inflation caused by supply shocks or rising food and fuel prices exacerbates adverse impacts on growth and employment, moderate inflation keeps real interest rates low and hence boosts investment. It also expands fiscal space through inflation tax (seignorage) and lower interest payments on debt.

3. Financial policy: financial deregulation and financial inclusion

39. Central banks play an important role in development. By reducing entry barriers and promoting financial inclusion through changes in the regulatory framework to encourage "banking agents", central banks can strengthen development. In the past, they were also able to ease the constraint of access to credit by firms through credit allocation policies. This played an important role in, for instance, the implementation of the strategy promoting heavy and chemical industries in the Republic of Korea and the decisive shift in credit deployment in favour of agriculture that occurred in India in the 1970s and 1980s. However, as a result of financial sector deregulation in the 1980s, there was a rollback of credit directed by specialized financial institutions to farmers and small and medium-sized enterprises. In particular, the pressure to be profitable, measured by the short-term criteria of volatile stock markets, has led to a wave of bank mergers and the exclusion of small and medium-sized enterprises and small borrowers from formal credit markets. With regard to financial sector deregulation, there has been an increase in banking and financial crises, which has had devastating impacts, particularly on the poor and middle-class people. Countries therefore need to revisit financial sector deregulation and strengthen prudential measures, as well as enhance financial inclusion.

4. Exchange rates and development

40. The choice of exchange rate regime is important since exchange rates have interdependent microeconomic and macroeconomic roles. They play an important microeconomic function of structural change between tradable and non-tradable sectors of an economy, and maintaining international competitiveness. The importance for macroeconomic policy lies in the close association between balance of payments outcomes, budget deficits and monetary policy stance. Exchange rates can impose discipline on macroeconomic policy by constraining the Government's ability to pursue unsustainable budget deficits resulting primarily from unproductive spending through the printing of money.

41. In the past three decades, many developing countries have officially moved away from a fixed exchange rate regime. Yet, their exchange rate regime is often not fully flexible in practice. Although it is argued in numerous studies that greater flexibility is not always an optimum policy for the developing world, past currency crises continue to prompt suggestions for more exchange rate flexibility. This is not, however, a panacea for all problems. Rather, countries should target exchange rate stability. This is vital for promoting economic growth and prosperity through international trade. It also has an important bearing on poverty reduction. Targeting exchange rate stability may, however, mean a certain loss of monetary independence if the country concerned cannot retain some control over short-term capital mobility or if capital mobility is significant.

5. Enhancing policy space and mitigating financial sector fragility through the management of capital flows

42. Private capital flows to emerging markets continue to surge since many developing countries have better growth prospects and interest rates are higher than in advanced countries. These inflow surges create significant policy challenges and are highly disruptive to development since they put upward pressure on exchange rates and dent export competitiveness. They can also increase inflationary pressures and trigger asset bubbles if reserve accumulation is left unsterilized.

43. Alongside monetary, fiscal and exchange rate policies, capital flow management is therefore an important measure to address the macroeconomic and financial stability risks associated with such capital surges. Several countries, including Indonesia, the Republic of Korea and Thailand, successfully introduced defensive measures against capital flows during the global financial and economic crises.

44. Managing capital flows is a country's sovereign right. Although opening the capital account is often seen as essential for enhancing investment, empirical evidence of the growth-enhancing effect of capital account liberalization is mixed. First, capital account convertibility reduces the impact of growth on poverty reduction by making after-tax income distribution more unequal. As capital account liberalization makes it easy for foreign direct investment to leave a country, developing countries end up offering various tax concessions to remain attractive. This shifts the tax burden from capital income to labour income. Second, the prospect of capital flight also forces Governments into a conservative fiscal policy stance, which often results in cuts in Government expenditure, especially in the social and infrastructure sectors. This restricts the ability to address priority sector development and human development. Third, capital account opening at lower

levels of development usually increases capital outflows. Countries also often respond with higher domestic interest rates, which adversely affect domestic investment. Moreover, high domestic interest rates may attract capital inflows but can adversely affect a country's international competitiveness and pace of industrialization owing to the "Dutch disease", namely, the apparent relationship between increased exploitation of natural resources and a decline in the manufacturing sector.

45. Capital account openness should therefore not be viewed as an all-or-nothing proposition. Rather, managing short-term capital flows can be beneficial to developing countries as it reduces the possibility of crises arising from volatile international capital flows. It also insulates domestic interest rates and the exchange rate and makes some room for expansionary monetary policy. In sum, prudential management of capital flows enhances both the stabilization and developmental roles of macroeconomic policies.

D. Investing in human development

46. Large development gaps in the region and within countries suggest that greater involvement of the State may be needed to address persistent macroeconomic, social and ecological imbalances in an integrated manner. To foster inclusive and sustainable development, Governments should pursue public policy actions that are based on the current economic, social and environmental situation and needs of the region. Strategies should address economic, social and environmental imbalances simultaneously, taking into account the impacts of policy measures on the three imbalances and giving the highest priority to policies that address more than one imbalance at the same time.

47. The provision of basic public services to all will be a critical element in making growth more resilient, inclusive and sustainable in the region. Six critical actions are: the provision of employment for all; income security for the elderly; income security for persons with disabilities; health care for all; education for all; and energy access for all.

E. Employment for all

48. Full employment as a goal is enshrined in the Charter of the United Nations (Article 55). High rates of unemployment and pervasive vulnerable and underemployment hamper growth and development. The inability of large proportions of the labour force to earn a safe and decent living limits their capacity to accumulate savings, leading to a low level of capital available for investment. It also limits their ability to invest in health and education, thus increasing the vulnerability of current and future generations. Concerted efforts to foster job creation should therefore represent a core element of national development policy in Asia and the Pacific. By providing employment opportunities through public works programmes or job guarantees, for instance, Governments would provide an important safety net for vulnerable workers and workers in the informal sector by providing them with a guaranteed source of income for a specified amount of time. Similarly, wage subsidies and employment opportunities, such as apprenticeships linked to active labour market programmes, could stimulate demand or provide incentives for re-employment.

49. Job guarantees and wage subsidies would also have important spill-over effects on national economies. For instance, programmes focused on infrastructure development could enhance productive capacities. If designed carefully, such programmes could also contribute to the greening of economic and productive capacity. Investments and expenditure that target social infrastructure can create additional employment and improve access by rural communities to basic social services.

50. Providing a 100-day employment guarantee that pays a wage equivalent to the national poverty line to everyone in the informal sector would not require large resources: in China and the Russian Federation just over 1 per cent of GDP; in Bangladesh, up to 8 per cent of GDP.

F. Income security for the elderly

51. Since the population is ageing in a large number of countries in the region, increased attention must be paid to the income security of older persons. When people grow older, their living standards often decline, usually as a result of reduced economic opportunities and a decline in their health status. Traditionally, societies in the Asia-Pacific region have relied on informal family-based support systems for old-age income security. However, rapid rates of urbanization and other social changes are contributing to a breakdown in these informal generational contracts. The vulnerability of older persons, especially in the informal sector, thus calls for the introduction of a mechanism that provides some form of income security for such persons.

52. While almost all countries in the region have a formal pension scheme, in general, coverage is skewed towards urban areas and the formal sector. Overall coverage of the labour force is relatively low: in developing Asia, an estimated 8 of every 10 workers are not covered. This implies that many persons, especially those who are single, widowed or childless (particularly women), face a high risk of destitution in old age. Several countries have introduced programmes in which eligibility is based on having reached a certain age and benefits are not means-tested. In Nepal, for instance, such a scheme was introduced in 1995; Brunei Darussalam has had one since 1984. Such schemes should be introduced more widely across the region. Overall, the cost of providing all persons over 65 years of age with a universal pension that is equivalent to the national poverty line would range between 1 and 4 per cent of GDP over the medium term (by 2030).

G. Income security for persons with disabilities

53. Approximately 650 million persons with disabilities live in the Asia-Pacific region. The limited availability of social protection in developing countries in Asia and the Pacific leaves this vast section of the population without sufficient coverage. According to an ESCAP study,[12] more than 70 per cent of persons with disabilities

[12] United Nations, Economic and Social Commission for Asia and the Pacific, *Disability, Livelihood and Poverty in Asia and the Pacific: An Executive Summary of Research Findings* (ST/ESCAP/2643). Available from www.unescap.org/sdd/publications/DL/SDD-Disability-Livelihood.pdf.

do not have enough income for self-support. This contrasts with many of the OECD member countries, which have generous disability benefits in place for a relatively large proportion of the population. It is therefore crucial that these persons have access to social protection on an equal basis with others. Providing the disabled with benefits equivalent to the national poverty line would cost far less than 1 per cent of GDP in the Asia-Pacific region.

H. Health for all

54. At the High-level Meeting of the General Assembly on the Prevention and Control of Non-communicable Diseases, in September 2011, Member States committed themselves to an all-out attack on such diseases as part of their campaign to achieve health for all (see resolution 66/2, annex). In 1981, the Global Strategy for Health for All by the Year 2000 was adopted, marking the birth of the "health for all" movement (see resolution 36/43).

55. Although tremendous improvements in health outcomes have been registered in the region since 1981, public health-care coverage can still be improved in many countries. Public health expenditure is particularly low in the least developed countries in the region. Moreover, inequities in health within countries in the region can be significant.

56. In recognizing that universal health-care coverage is a critical component of inclusive and sustainable development, in 2011, 193 member States of the World Health Organization (WHO) committed to move towards universal health-care coverage. However, progress has been patchy, especially in the Asia-Pacific region, where only 20 per cent of the regional population has access to health-care assistance and out-of-pocket medical expenses are among the highest in the world. In South Asian countries, for instance, only 8 per cent of the population is covered by health-care programmes. While efforts to move towards universal health care coverage need to be intensified in Asia and the Pacific, all countries in the region should increase public expenditure on health care to at least 5 per cent of GDP, as recommended by WHO. Doing so would not require extensive resources.

I. Education for all

57. Education for all is another internationally agreed development goal, adopted at Dakar in 2000.[13] Education is one of the cornerstones of inclusive and sustainable development. More education for women has important impacts on the health of children and contributes to lower reproduction rates, irrespective of a country's level of development; it is also clear that education has a positive effect on health outcomes, earnings and economic growth.

58. Many countries in the region have already achieved universal primary education. However, more efforts to expand primary schooling in the region are needed. An estimated one fifth of the 61 million children of primary school age who are not in school worldwide live in South Asia alone. However, completing primary

[13] See *Final Report of the World Conference on Education for All: Meeting Basic Learning Needs, Jomtien, Thailand, 5-9 March 1990*, Inter-Agency Commission (UNDP, UNESCO, UNICEF, World Bank) for the World Conference on Education for All, New York, 1990, appendix I.

education is no longer sufficient to meet the demands of the increasingly sophisticated labour force that arises as countries develop. Governments must therefore also commit to achieving universal enrolment in secondary education. By increasing public expenditure on primary and secondary education by less than 1 per cent of GDP, most countries in the region would be able to reach these two goals.

J. Energy access for all

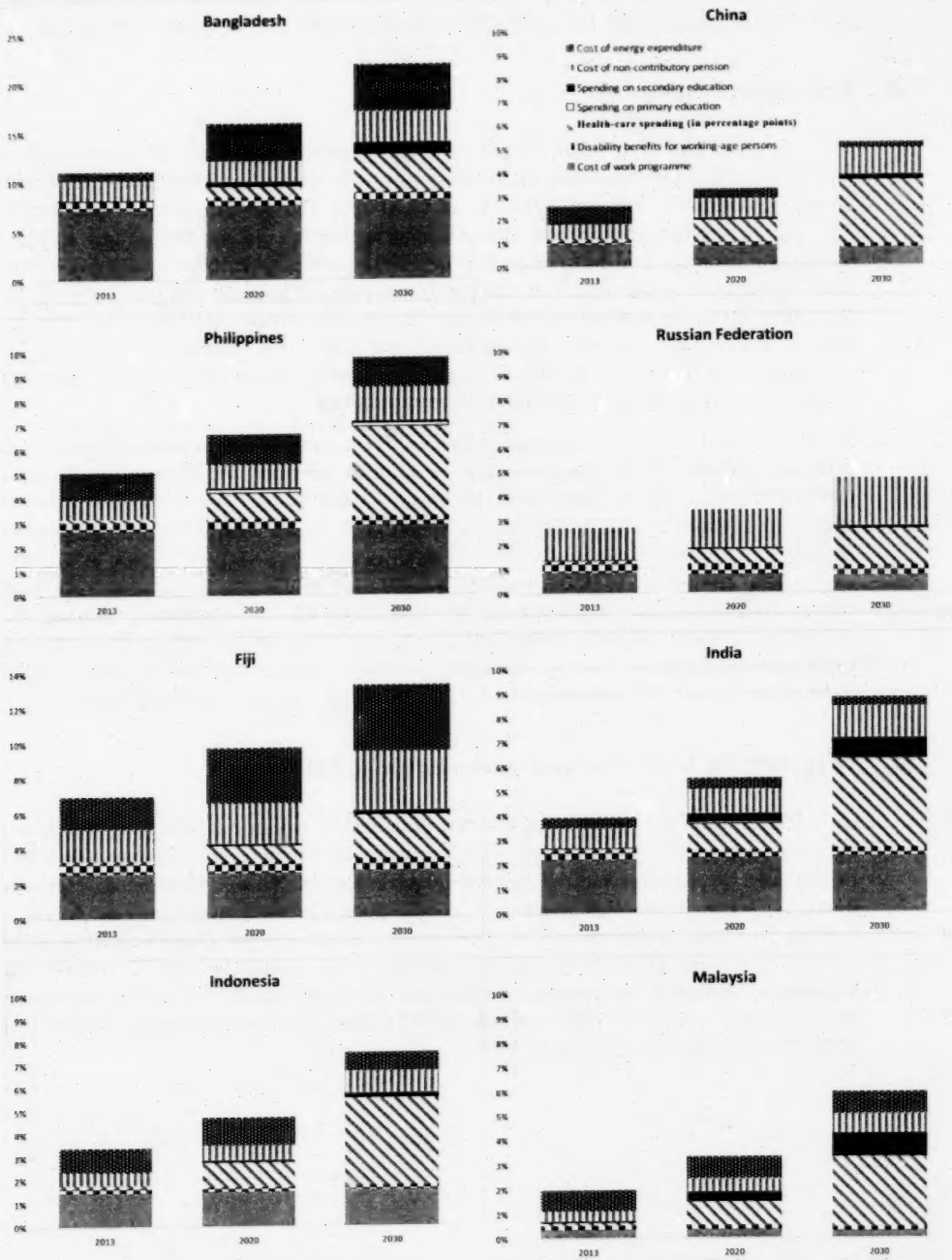
59. To draw global attention to the problems regarding the scale of energy access and to spur the international community towards action, in December 2010, the General Assembly declared 2012 the International Year of Sustainable Energy for All (see resolution 65/151). In the Asia-Pacific region, 1.7 billion people rely on traditional biomass and more than 600 million people live without electricity. More than 70 per cent of the people in the Pacific still do not have access to electricity. At the same time, economic growth in the region is exerting significant pressure on natural resources. National and regional policies must therefore be aimed at designing sectoral policies, especially in the energy sector, that support poverty eradication and promote environmental sustainability.

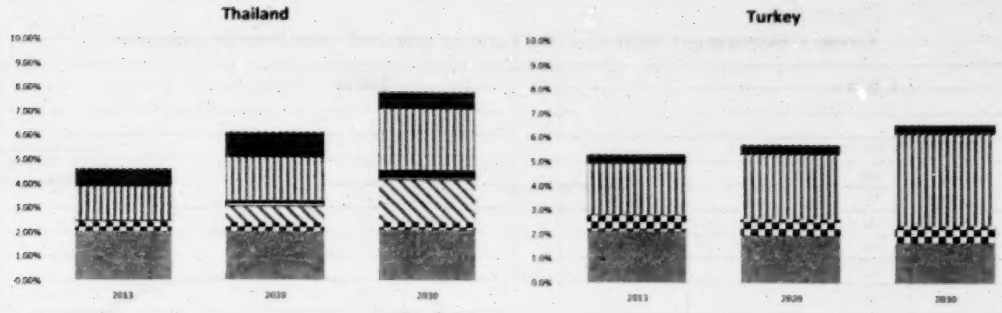
60. Universal access to energy services is essential for increasing economic activities, which create opportunities for employment for all. Burning inefficient cooking fuels, such as traditional biomass, causes indoor air pollution; lack of access to modern cooking fuels therefore poses a severe health hazard. Increasing access to modern, clean and efficient energy is a key driver of inclusive and sustainable development. Governments should address these policy matters through energy policies aimed at improving the efficiency of, and increasing the use of, renewable energy in each country's energy mix. The additional average annual investment required to provide universal access to energy services by 2030 ranges from about a third of 1 per cent of GDP in Turkey to 3 per cent in Bangladesh.

K. Investing in inclusive and sustainable development

61. The overall investment expenditure required to provide a job guarantee to all persons engaged in the informal sector, ensure universal access to education and health-care services, provide disability benefits and an old-age pension, and ensure universal access to modern sources of energy varies between countries (see figure 5 below). In China, requirements are projected to reach 3.3 per cent of GDP in 2020 and 5.2 per cent of GDP by 2030, when all goals would be met. Estimates for Indonesia, Malaysia, the Russian Federation, Thailand and Turkey range between 5 and 8 per cent of GDP; in Bangladesh and Fiji, they would remain under 10 per cent of GDP throughout the period to 2030.

Figure 5
Total expenditure required to provide a job guarantee to informal sector workers in selected Asia-Pacific countries





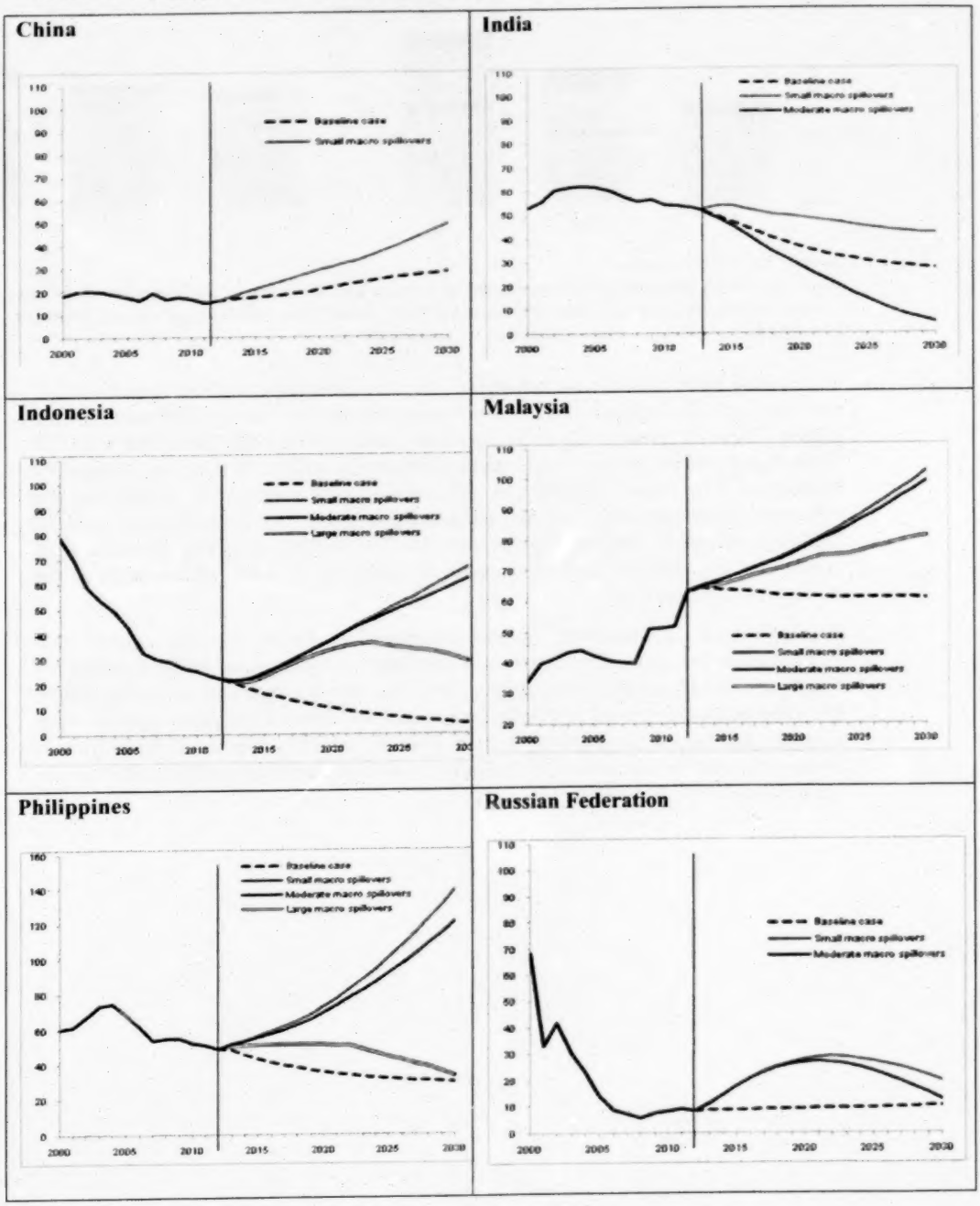
Source: ESCAP calculations.

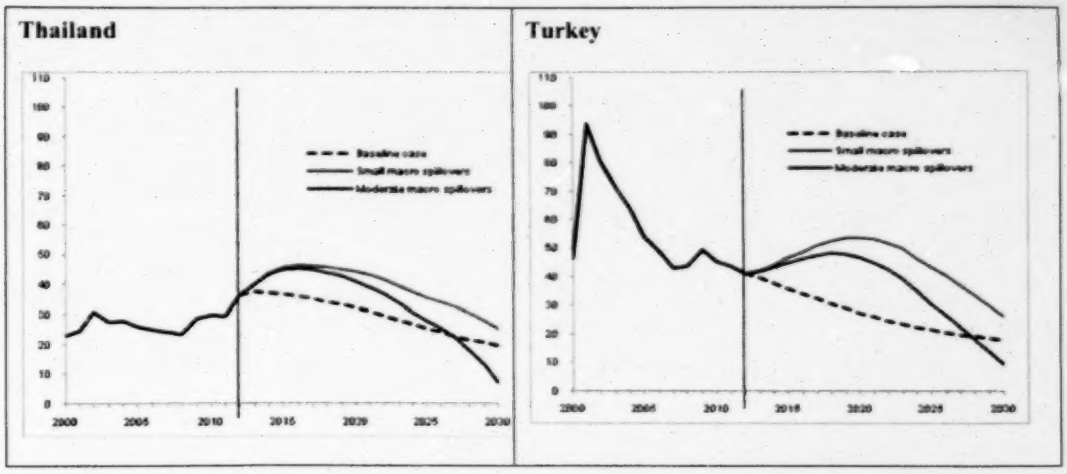
Note: For Turkey, data on public expenditure on primary and secondary school expenditure are unavailable and not included in the graph. Since access to energy is already universal in the Russian Federation, no additional investment and expenditure is required for this indicator.

62. While these amounts are not trivial, they are affordable, especially considering the relatively low expenditure-to-GDP ratios and tax revenue-to-GDP ratios in the region. As such, greater domestic resource mobilization could raise the required financing. Possible options would include enhancing efforts to raise tax revenue by broadening tax bases, making tax structures more progressive, improving the efficiency of tax administration and introducing creative revenue policies to increase available resources. Earmarking tax revenues for socially desirable investment or conducting a campaign, such as "tax for development", would likely improve the incentives for paying tax.

63. Moreover, a long-term macroeconomic simulation exercise shows that Governments can pursue inclusive and sustainable development while maintaining fiscal sustainability and price stability. Thus, the direct impact of additional public spending on output growth and indirect impacts on labour force participation, wage earnings and labour productivity would lead to sustainable future debt paths (see figure 6 below). At the same time, inflation would remain manageable under various simulation scenarios considered.

Figure 6
Gross Government debt-to-GDP ratio in selected Asia-Pacific countries





Source: *ESCAP* calculations, based on the Oxford Global Economic Model.
Note: Baseline cases are projections made by the Oxford model when no shocks are imposed on any variables. The same scale is used in all figures except for that of the Philippines.

64. This is an encouraging finding for countries committed to deliver on their citizens' basic right to development. By doing so, they can at the same time enhance the resilience of their people, improve human security, make development more inclusive and thereby strengthen sustainable development. In sum, investing in health, education, and income and energy security is a win-win solution to both short-term and long-term challenges to resilient, inclusive and sustainable development.